Commonwealth of Puerto Rico

Tax Reform Assessment Project

Unified Tax Code of Puerto Rico:

Tax Policy Implementation Options

Executive Summary

October 31, 2014

Table of Contents

1. Executive Summary

1. 1 Scope of Project

On August 17, 2013, the Governor of the Commonwealth of Puerto Rico issued an Executive Order creating a Tax Reform Advisory Group to analyze the current tax system, its rules and administration and report its conclusions and recommendations to build an effective and fair tax system. The Executive Order explicitly recognized the need to take measures to address the fiscal crisis facing the Commonwealth. It also implied that those measures should not have an adverse impact on the working class or consumers.

The Executive Order enumerated a number of specific factors to be considered:

- The interaction of the components of the state and local tax system and its impact on individuals and businesses;
- The need to restructure, eliminate or extend these components to achieve the desired revenue objectives and simultaneously facilitate economic development
- Analysis of existing tax preferences to determine their effectiveness, elimination or restructuring to align them with the Commonwealth's economic development plan
- Analysis of the current system's promotion of equity in the distribution of the tax burden between the working class and the business and industrial base of the economy
- Evaluation of the current structure of tax administration to improve compliance and efficiency
- Comparison of the tax structure of Puerto Rico with successful tax structures of countries with similar economic and social priorities, and
- The views of diverse interest groups.

On March 18, 2014, KPMG contracted with the Treasury to make a full assessment of the Puerto Rican tax structure and to develop a full report and set of alternative scenarios for Treasury to evaluate for a simplified tax system that will provide the desired revenues through a more streamlined and effective system that should also result in more effective oversight. Analysis of the individual income tax was specifically excluded from the scope this contract. Analysis of the property tax was not included.

On May 6, 2014, KPMG contracted with the Treasury to expand the scope of the engagement to include the individual income tax.

Subsequent meetings with the Secretary of the Treasury and her colleagues refined the goals of the project to include the following:

- Produce adequate revenue
- Distribute the burden of taxation fairly
- Promote economic growth
- Increase international competitiveness of products, workers and businesses
- Minimize interference with private decision making
- Streamline compliance and administration

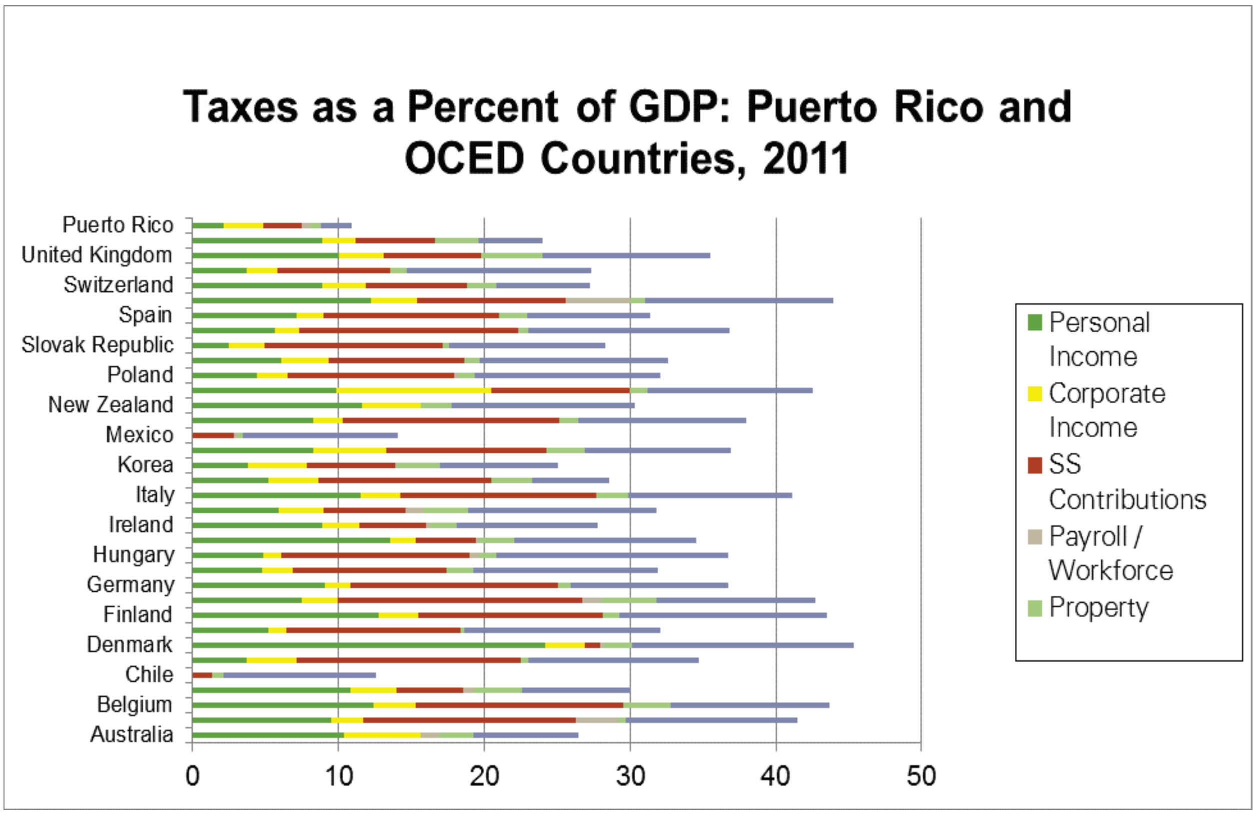
Case:17-03283-LTS Doc#:18760 Filed:10/26/21 Entered:10/26/21 14:47:06 Desc: Main Document Page 4 of 5

1.3 Summary of Principal Findings

1.3.1 High Level Observations

The current income and consumption tax structures are inordinately complex, due principally to a plethora of special provisions that for the most part were adopted in a haphazard manner over time generally to provide incentives for particular forms of economic activity. These special provisions have never been subjected to a cost benefit analysis. As shown in Tables 1 and 2, revenue from consumption and income taxes are below peer jurisdictions.

Table 1: Taxes as a Percentage of GDP in Puerto Rico Compared to Selected Jurisdictions[4]



[4] (*) While Table 1 uses GDP as the measure of comparison across countries, the results are similar when using GNP as the measure of comparison. Puerto Rico taxes as a percentage of GNP is closer to 15% but still substantially lower than the tax liability of the peer countries shown.

Table 2: Tax Collections as Percent of GDP -- Comparison of Puerto Rico to OECD Countries

	Puerto Rico	Average	Range
Personal Income	2.2%	8.3%	2.2 - 24.2%
Corporate Income	2.7%	3.0%	1.2 - 10.70%
SS Contributions	2.75%	9.00%	0.00 - 16.70%
Payroll/Workforce	0.21%	0.41%	0.00 - 4.44%
Property	0.75%	1.76%	0.29 - 4.16%
Goods/Services	2.216%	10.77%	2.06 - 15.91%
Total	10.66%	33.19%	

Table 3 presents data on the distribution of income and tax liability and shows that less than 10 percent of filers are responsible for almost 78 percent of income tax receipts.

Table 3: 2013 Income Tax Liability by Income Class (In Millions of USD)[5]

Income Level	Filers	Tax Liability (Excluding SS & Medicare)	Share of Tax (Excluding SS & Medicare)	Tax Liability (Including Social Security and Medicare)	Share of Tax (Including Social Security and Medicare)
Less than $20,000	538,026	$4	.2%	$368	9.6%
Between $19,999 and $40,000	319,108	$191	9.2%	$791	20.6%
Between $39,999 and $60,000	107,107	$270	13.0%	$604	15.7%
Greater than $59,999	89,459	$1,614	**77.6%**	$2,079	54.1%
Total	**1,053,700**	**$2,079**	**100.0%**	$3,842	**100.0%**

[5] Distributional analysis based on 2012 individual tax returns provided by Department of Treasury.